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## Much Ado About a Little Something?: Oversight Duties Extended to Corporate Officers

Before the Chancery Court's decision in *In Re McDonald's Corporation Stockholder Derivative Litigation*, the fiduciary duty of oversight was only imposed on corporate directors, not corporate officers.

By **Joseph Monteleone** | March 21, 2023



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Courtesy photo.

Vice Chancellor J. Travis Laster of the Delaware Chancery Court recently issued a lengthy opinion in *In Re McDonald's Corporation Stockholder Derivative Litigation*, 2023 Del. Ch. LEXIS 24 (Del. Ch. 2023), a shareholder derivative suit brought against former CEO Stephen J. Easterbrook, former chief people officer David Fairhurst, and other company directors.

The decision was significant because it extended the fiduciary duty of oversight to corporate *officers* under applicable Delaware law. Originally, through the court's decision in *In re Caremark Int'l Inc. Derivative Litigation*, 698 A. 2d 959 (Del. Ch. 1996), that duty was one only imposed on corporate *directors*. The opinion addressed solely the claims against Fairhurst in deciding a motion to dismiss he had filed. Motions to dismiss were also filed by Easterbrook and the director defendants, but they were not addressed in this decision.

In summary, the oversight claims against Fairhurst were based upon his failure to manage pervasive sexual harassment issues at the company and the fact that he personally also engaged in such harassment of employees on a number of occasions. Ultimately, Fairhurst and Easterbrook were terminated separately in 2019 over the conduct at issue here.

*In Re McDonald's* has caused quite a stir in both the areas of corporate governance and the D&O insurance community, as those insurers will ultimately bear the financial brunt of any increased frequency of these oversight claims. A careful reading of the opinion, which may well be appealed to the Supreme Court of Delaware, indicates that it was quite fact-specific and not an altogether surprising result. Indeed, it is not likely that any other officer in the company, save for perhaps the CEO, could have been tagged with *Caremark* liability for the sexual harassment allegations at issue here.

Fairhurst brought his motion to dismiss essentially on the basis that *Caremark* duties do not extend to corporate officers. The Court made clear that officers owe the same fiduciary duty of oversight as do directors "as to matters within their areas of responsibility." As such, it makes eminent sense that Fairhurst would owe these oversight duties with regard to matters such as sexual harassment because that was clearly within his area of responsibility as Chief People Officer of the company. In that sense, an officer's duty of oversight is more limited than that imposed upon directors.

The Court held that officers had a duty to monitor "red flags" within their area of responsibility and report to their superiors when such red flags are noted. Interestingly, in this case Fairhurst's superior would be the CEO, Easterbrook, who was allegedly also enmeshed in the same harassment scenarios. The Court noted that a CEO would have a "company-wide remit", but did not further address Easterbrook's liability,

Based upon the Court's reasoning, it is unlikely that oversight claims could be sustained against Fairhurst if the area were food safety as in *Marchand v. Barnhill*, 212 A.3d 805 (2019), a well-known duty of oversight decision from the Supreme Court of Delaware. That decision focused on "mission critical" areas such as food safety in a company that was an ice cream manufacturer and distributor. No similar mission critical analysis took place in *McDonald's*, but the Court instead focused on the "red flags" issues.

The Court also noted that liability should only attach to directors or officers in these situations if they acted in bad faith and breached their duty of loyalty to the company. In this case, the Court held that Fairhurst's own acts of sexual harassment constituted bad faith and a breach of the duty of loyalty.

Many commentators, including those in the D&O insurance community, have expressed concern that *McDonald's* may lead to a plethora of employment law claims being repackaged by shareholders as *Caremark* claims and brought in the Delaware Chancery Court. Those concerns may not prove to be well-founded because the facts in *McDonald's* were particularly egregious. Ordinarily, these claims would not involve misconduct at the officer level and would be directed solely against the company, which in derivative litigation is only a nominal defendant. Based upon the reasoning of the Court, the claims at issue here could likely only withstand dismissal as to an officer such as Fairhurst who had responsibility for human resources and employment matters.

It would be very interesting, however, to see how these claims may be addressed down the road in this litigation as to the former CEO and the director defendants. The CEO and the directors would appear to be in different situations, with the CEO possibly in the same category as Fairhurst, but the directors likely in the same situation as with other *Caremark* claims where motions to dismiss are still regularly granted. While other Delaware courts and commentators have observed how difficult it is for shareholder plaintiffs to successfully plead a *Caremark* claim, the Court here made no reiteration of this supposed truism. That may be because with this decision and earlier decisions in *Marchand* and *In re Boeing Co. Derivative Litig.*, No. 2019-0907-MTZ, 2021 Del. Ch. LEXIS 197 (Del. Ch. Sep. 7, 2021), successful *Caremark* claims may no longer be such rare occurrences.

That being said, adding officers as potential defendants in these types of claims may have a significant impact on insurers' defense expense exposure. It should be duly noted that in *McDonald's*, separate counsel represented Fairhurst and Easterbrook in addition to the counsel that represented the director defendants. That makes for three defense firms, where normally there would only be a single firm representing the directors. In derivative litigation, this can result in significantly more, perhaps triple the amount, defense costs liability to the insurer.

As far as D&O insurer concerns about possible increased litigation frequency or opening floodgates in this area, the verdict is still out pending any appeal of this decision and how the courts may address the liability of the director defendants and Easterbrook. Even if Easterbrook is tagged with liability because of his "company-wide remit", that may not be so shocking given the facts here.

*These views are the author's own.*

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